THE WALL STREET JOURNAL. ONLINE

PAGE ONE

Asian Rivals Put Pressure On Western Energy Giants

In a String of Recent Deals, China, India Display Clout, Funds and Stomach for Risk

By ANDREW BROWNE in Hong Kong, BHUSHAN BAHREE in New York, PATRICK BARTA in Bangkok and JOHN LARKIN in Bombay
Staff Reporters of THE WALL STREET JOURNAL
January 10, 2005; Page A1

Major Western oil companies, already feeling squeezed as easy-to-exploit oil and natural-gas fields become scarcer, have brash new rivals to contend with in Asia.

As a flurry of proposed and completed deals attest, energy companies in India and China want bigger slices of the global oil patch. They're aided by the political and financial might of their government backers and spurred by the need to keep their billion-person economies racing ahead and to ease their dependence on oil and gas imports.

The companies have other advantages. They don't shy from oil-rich countries like Sudan deemed too dangerous or politically unsavory in the West. They settle for less-favorable commercial terms that scare away Western competitors cowed by demanding shareholders. And they're more prepared to risk losses drilling holes that come up dry.

On Friday, India signed a 25-year agreement to import liquefied natural gas from state-owned National Iranian Gas Export Corp. starting in 2009. It also agreed to develop three oil fields in Iran, the second-largest exporter after Saudi Arabia in the Organization of Petroleum Exporting Countries.

China and Canada could be ready this month to sign a general agreement on Chinese investment in Canadian oil resources, including so-called oil sands in the province of Alberta, although details are still sketchy.

India's state-owned Oil & Natural Gas Corp. said it had its eye on a stake in Yuganskneftegaz, the key oil-production unit of troubled Russian oil giant OAO Yukos. Yugansk, as it is known, produces 1% of world crude output. Just a few weeks ago, Russia said it would offer a minority stake in the same asset to China. There has been no official Russian comment on either deal.

And in the most eye-catching evidence so far of these global ambitions, China's third-largest oil-and-natural-gas company, China National Offshore Oil Corp., may be interested in buying Unocal Corp., the ninth-largest U.S. oil company in terms of reserves. Investment bankers in Hong Kong confirmed the Chinese company's interest. (See related article[1].)

"Over the next 10 years, Chinese and Indian oil companies will emerge as major players in the global oil industry," says Daniel Yergin, oil historian and chairman of Cambridge Energy Research Associates in Cambridge, Mass. "It reflects the reality of economic growth and the scope of China and India in the world oil market."

A key reason the Chinese and Indian oil companies have a chance to challenge the U.S. and European giants is that the Western majors are losing their stomach for risk. Investors in the majors insist on high returns on any drilling or exploration project into which the companies pour their dollars, a practice the industry dubs "capital discipline."

The obsession with returns derives from the 1990s, when the high-technology sector sucked in capital and the oil industry was seen headed the way of steel and coal, mature industries faced with low prices and dim financial prospects. The oil-price crash of 1997-1998 reinforced this view, and the more successful oil companies gobbled up weaker ones.

"At the end of the day, [Chinese and Indian companies] don't have shareholders," says Rick Mueller, an analyst at Energy Security Analysis Inc., a Wakefield, Mass., consulting company.

There isn't a Chinese Exxon Mobil Corp. on the horizon. Indian and Chinese companies lack the technology and know-how offered by their Western competitors. Some analysts question the commercial merits of China's interest in Unocal, and it would be a huge swallow for China National Offshore Oil. Politically, it might prove impossible for China to buy one of the biggest U.S. companies, even assuming any were for sale.

Nor does the growing economic might of China and India guarantee that they will spawn energy giants as mighty as Exxon Mobil or BP PLC. Japan, Asia's first economic superpower, tried in the 1970s and '80s to create a national oil powerhouse but failed.

But the Unocal idea indicates that China may have learned from Japan's mistakes. Japan invested heavily in exploration; China is more focused on buying existing, producing assets. And while those fields don't come close to meeting China's demand, they give its oil companies an opportunity to pick up the technical expertise they need to become more formidable competitors to Western rivals in the years ahead. India, too, is going for existing oil and natural-gas assets abroad.

China, long self-sufficient in oil, is now becoming one of the world's biggest importers, and accounted for more than half of world oil-demand growth in 2002 and 2003. The IEA expects China to be importing 82% of its oil by 2030. Right now, China's biggest oil companies have massive reserves but aren't nearly as productive as the Western majors. What is more, it now appears that predictions of an oil bonanza in China's offshore fields and in its remote far west have been overblown, giving added impetus to China's overseas shopping expeditions.

India has the world's fastest-growing car market, which is driving oil consumption and imports. The International Energy Agency forecasts oil demand in South Asia will grow by 3.3% a year between 2000 and 2030, the highest of any region in the world.

The Western majors and the Asian energy companies all face the same big problem: a lack of easy-to-tap oil. The vast oil reserves of the Persian Gulf states, some two-thirds of the world's total, are mostly off-limits to foreign companies. International oil giants jealously guard choice assets elsewhere, and have already picked over the best of the smaller oil companies on sale. China was rebuffed in 2003 by Western majors when it tried to grab a stake in an enormous field in Kazakhstan.

At the same time, the growing obsession of China and India with owning oil and gas assets for energy security means they are likely to pay high prices.

The Chinese, despite their famed negotiating skills, "are noted for overpaying" in the commodities sector, says David Hurd, a Hong Kong-based energy analyst with Deutsche Bank. Japan discovered how costly miscalculation can be when it tried to develop its own energy giant: A state-owned Japanese oil-exploration company ended up as a black hole for taxpayers and was disbanded last March with debts of at least one trillion yen, or about $9.5 billion, and little oil to show for its 300 exploration projects. Japan now buys its oil on global markets.

Another problem for the huge Asian neighbors may be their own rivalry. Distrust runs deep between them. ONGC Videsh, the Indian unit dealing with equity oil purchases, has spent more than $3.5 billion since 2000 in its global hunt for energy. Most of this has gone to stakes in blocks in Syria, Angola, Russia and Sudan. But the Chinese regularly outbid India for the juiciest leases. As a sweetener to a deal last year in Angola, the Chinese extended a $2 billion loan to help the nation build infrastructure after three decades of civil war. While the deal has yet to be completed, industry observers say India seems to have been left out in the cold after offering substantially less in credit.

"They get beaten by the Chinese on almost every important deal nowadays," says Madhu Nainan, editor in chief of Petrowatch, an online petroleum-industry newsletter in India. "Maybe the Indians aren't willing to play the game the way the Chinese are."

China is worried that most of its oil is shipped on sea lanes that run close to the Indian subcontinent, says Mikkal Herberg, director of the Asian Energy Security Program at the National Bureau of Asian Research in Seattle. Partly to counter this, Mr. Herberg says, it is projecting its navy into regional waters. That, in turn, has India worried about the security of its own sea lanes. "There is the potential in broad terms for rivalry between China and India," he says.

China and Japan are already scrambling for resources in Russia. Beijing felt bitterly betrayed this month when Moscow opted to build an oil pipeline from Siberia to the Pacific coast, a jumping-off point for Japan, instead of to China's oil heartland around Daqing in the northeast.

When China pitches for energy business in countries from Angola to Ecuador it can offer a wealth of inducements -- everything from interest-free loans to help building phone networks, plus political benefits that flow from its role as a permanent member of the United Nations Security Council.

Some oil strategists see this kind of broad state-to-state cooperation as a potential threat to the current energy giants in the private sector. Indian and Chinese oil companies often act less as commercial entities and more as extensions of government policy. In the future, some oil experts say, big oil-producing countries will increasingly cut deals directly with big oil-consuming countries, leaving state companies to ink in the details.

--Martin Fackler in Tokyo contributed to this article